

Intermediate Muni Quarterly Commentary

THIRD QUARTER 2016

Macro Overview

As we entered the third quarter, Brexit still dominated headlines as markets attempted to predict what the eventual fallout would look like for Britain, the Eurozone and the rest of the world – the fact is, we still don't know. US Treasury yields finally found a bottom after the 10-yr benchmark traded below 1.40% in the days following the 4th of July holiday. From there, Treasuries traded in a relatively tight range, eventually pushing higher, led by the front-end of the curve. Yields on 3-yr, 10-yr, and 30-yr Treasuries were up 18, 13, and 3 basis points, respectively. The typically quiet summer months of July and August saw headlines turn to the upcoming presidential election where Donald Trump surprisingly secured the Republican nomination and Hillary Clinton finally put away a pesky challenge from Bernie Sanders. The fodder between the two camps has consumed news cycles with the expectation for it to escalate further heading into November.

Outside of politics, central banks and their policies paved the way for traders. In early September, a hawkish twist from Mario Draghi disappointed markets as he downplayed the chance for further stimulus out of the ECB. Meanwhile the BOJ, which reportedly considered the strategy of helicopter money, undertook the unconventional policy of yield curve control in its latest attempt to spur economic growth. Here at home, the Fed entered the quarter with a less accommodative tone after it was unwilling to raise rates in the first half of the year. However, a weak Q2 GDP print (1.1%) and a revision lower in Q1 (0.8%) coupled with ongoing global uncertainty and stubbornly-low inflation sidelined their effort. Hawks who pointed to a strengthening labor market (monthly NFP avg. 182K YTD) believe the Fed may have missed its chance in September, and with the November meeting right in front of the election, most predict December will be the Fed's only chance to raise in '16.

Market Dynamics

Municipal yields drifted higher throughout the quarter, in-line with but slightly underperforming Treasuries in the short to intermediate portion of the curve. The 3-yr and 10-yr AAA MMD Index increased 22 and 16 basis points, slightly more than 3-yr and 10-yr benchmark Treasuries, which were up 18 and 13 basis points, respectively. However, there was notable underperformance on the long end, where the yield on the 30-yr AAA MMD Index increased 29 basis points vs. only 3 basis points for the 30-yr Treasury. Much of the underperformance can be attributed to the barrage of supply in September, which set a record for the month going back to 1986. Through the first three quarters, over \$330 billion of bonds have priced, and total issuance should now easily reach our \$400 billion prediction and could potentially eclipse 2010's record issuance total of \$433 billion. Although fund inflows continued throughout the quarter (52 consecutive weeks), the robust issuance began to take its toll on the sector, weakening technicals into quarter-end. Muni-to-UST ratios have widened to the point that they may again entice cross-over buyers who could help absorb the increased supply. We expect issuance to remain elevated as borrowers rush to the market in front of a potential late-year Fed hike and uncertainty surrounding November's election, but expect these pressures to subside as we move closer to year-end.

Composite Characteristics

INTERMEDIATE MUNI –
STATE SPECIFIC

AS OF: 09/30/2016

Duration: 4.56 yrs

Yield-to-Worst: 1.41%

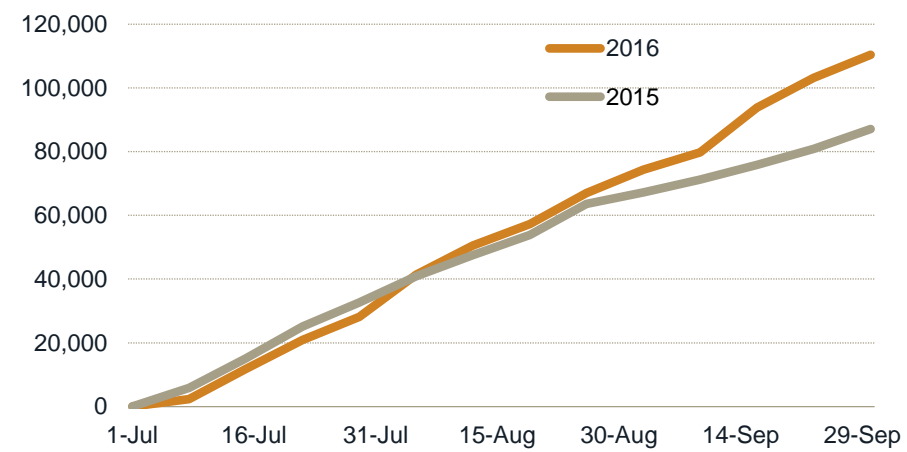
Yield-to-Maturity: 1.65%

Maturity: 6.63 yrs

Performance Notes

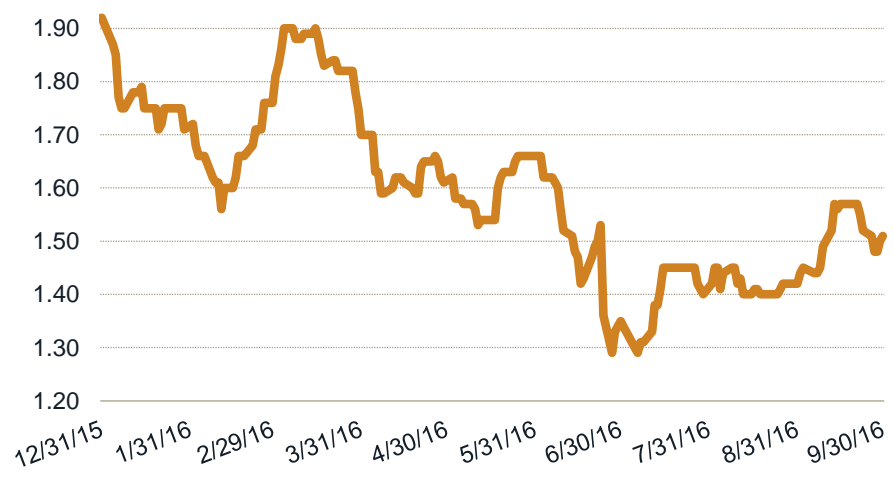
Maturity and duration positioning across the yield curve remained the largest contributor to performance over the quarter. Our slightly longer-than-neutral duration targeting and preference to maturities in the 10 to 15 year portion of the curve led to composite performance in-line to slightly below benchmarks for the quarter. The weakness in September was the largest detractor to quarterly performance, pushing total returns slightly negative for the period. At this point, we continue to think that global growth and inflation remain muted and the prospect of a quick economic turnaround to be subdued. While respecting the moderately higher yield volatility in September, our outlook still views the strategy's intermediate maturity positioning as a prudent decision for capital conscious investors seeking tax efficient income.

FIGURE 1: TOTAL MUNICIPAL ISSUANCE 3rd QUARTER YOY (\$Bln)
Source: Bloomberg



“While respecting the moderately higher yield volatility in September, our outlook still views the strategy’s intermediate maturity positioning as a **prudent decision for capital conscious** investors seeking tax efficient income.

FIGURE 2: 10-YEAR MMD AAA MUNI YIELD
Source: MMD



Contact Information

1802 Bayberry Court, Suite 202
 Richmond, Virginia 23226
 804] 648-3333
 CAPRINBONDS.COM
 Media Contact:
 aplotkin@caprinbonds.com

Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this piece, will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for your portfolio. Due to various factors, including changing market conditions, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion of information contained in this piece serves as the receipt of, or as a substitute for, personalized advice from Caprin Asset Management. To the extent that a reader has any questions regarding the applicability to their situation of any specific issue discussed above, they are encouraged to consult with the professional advisor of their choosing. A copy of our current written disclosure statement discussing our advisory services and fees is available for review upon request.